

Motion to Dismiss  
Nondischargeability  
§§ 523(a)(2), (4) and (6)

Schwartzberg Associates v. Helmut and Helga Schwartz 98-6068-  
fra

(In re Helmut and Helga Schwartz 697-64654-fra7)

7/14/98

FRA

Unpublished

The Plaintiff is a creditor of the Defendants' corporation, Schwartzberg Vineyards, Inc. (SVI). SVI filed bankruptcy first in 1992 under Chapter 12. When that case was dismissed, a subsequent Chapter 12 petition was filed. When the second bankruptcy was dismissed, SVI filed a Chapter 11 petition which was later converted to Chapter 7. The Defendants filed a joint Chapter 7 petition at the time SVI filed its final petition.

The Defendants were directors, officers, and the major shareholders of SVI. The Plaintiff filed a complaint against the Defendants, alleging that actions taken by the Defendants, including the willful violation of court orders, make Plaintiff's claim nondischargeable under §§ 523(a)(2)(A), (a)(4), and (a)(6). Defendants answered that the Plaintiff's claim is against SVI, not them personally, and filed a motion to dismiss for failure to state a claim upon which relief can be granted.

A complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief. The court denied the motion to dismiss, holding that it was not beyond doubt that the facts presented by the Plaintiff could be proven to give rise to a nondischargeable claim against the Defendants, although the claim may not be in the same amount as Plaintiff's claim against SVI.

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8 UNITED STATES BANKRUPTCY COURT  
9 DISTRICT OF OREGON  
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11 IN RE )  
12 HELMUT AND HELGA SCHWARZ, ) Case No. 697-64654-fra7  
13 Debtors. )  
14 SCHWARZENBERG ASSOCIATES, ) Adv. Proc. No. 98-6068-fra  
15 Plaintiff, )  
16 v. )  
17 HELMUT SCHWARZ, and )  
18 HELGA SCHWARZ, ) MEMORANDUM OPINION  
19 Defendants. )

20 BACKGROUND

21 Defendant, Helmut Schwarz, was a shareholder, director, and  
22 President of Schwarzenberg Vineyards, Inc. ("SVI"). SVI filed a  
23 Chapter 12 bankruptcy on November 9, 1992 which was eventually  
24 dismissed on May 24, 1996. A second Chapter 12 bankruptcy was  
25 commenced on July 5, 1996 and was dismissed on December 9, 1996.  
26 A Chapter 11 bankruptcy was filed on August 14, 1997 which was

1 converted to a case under Chapter 7 on October 24, 1997.  
2 Defendant Helga Schwarz was a shareholder, director, and Vice  
3 President of SVI. The Defendants Schwarz filed for bankruptcy in  
4 their individual capacity under Chapter 7 on August 14, 1997.

5 The Plaintiff, Schwarzenberg Associates, had entered into a  
6 line of credit agreement with SVI on December 29, 1993, with  
7 borrowed funds secured by an Accounts Receivable and Inventory  
8 Loan and Security Agreement dated December 29, 1993 and a second  
9 security agreement and financing statement filed April 12, 1996.  
10 The Plaintiff filed an action against SVI in Polk County Circuit  
11 Court on January 23, 1996 to collect on its note and foreclose  
12 its security interest. The Plaintiff filed this complaint  
13 alleging that its claim of \$381,134 is nondischargeable under 11  
14 U.S.C. §§ 523(a)(2)(A), 523(a)(4), and 523(a)(6). It alleges  
15 that the Defendants directed SVI to violate the security  
16 agreements, two temporary restraining orders issued in state  
17 court, a stipulated order entered in state court, a preliminary  
18 injunction entered in state court, and the terms of a cash  
19 collateral order entered in Bankruptcy Court.

20 Defendants filed a motion to dismiss under Fed. R. Civ. P.  
21 12(b)(6), made applicable by Fed. R. Bankr. P. 7012, for failure  
22 to state a claim upon which relief can be granted. Defendants  
23 argue that the Plaintiff's claim is against the corporation SVI,  
24 not against the Defendants, and the complaint does not allege  
25 otherwise.

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1                    MOTION TO DISMISS UNDER RULE 12(b)(6)

2            "[A] complaint should not be dismissed for failure to state  
3 a claim unless it appears beyond doubt that the plaintiff can  
4 prove no set of facts in support of his claim which would entitle  
5 him to relief." Amfac Mortgage Corp. v. Arizona Mall of Tempe,  
6 Inc., 583 F.2d 426, 429 (9th Cir. 1978) (citing Conley v. Gibson,  
7 355 U.S. 41, 45-46 (1957)). "On a motion to dismiss, the  
8 complaint is construed in favor of the pleader. . . .And any  
9 doubts are resolved in favor of the pleader." Id. at 430  
10 (internal citations omitted).

11           A court "may not consider any material beyond the pleadings  
12 in ruling on a Rule 12(b)(6) motion." Hal Roach Studios, Inc. v.  
13 Richard Feiner and Co., Inc., 896 F.2d 1542, 1555 n. 19 (9th Cir.  
14 1990). "Material which is properly submitted as part of the  
15 complaint may be considered on a motion to dismiss." Id. "A  
16 document is not 'outside' the complaint if the complaint  
17 specifically refers to the document and if its authenticity is  
18 not questioned." Branch v. Tunnell, 14 F.3d 449, 453 (9th Cir.  
19 1994) (citing Townsend v. Columbia Operations, 667 F.2d 844, 848-  
20 849 (9th Cir. 1982)).

21                    ANALYSIS

22            **11 U.S.C. § 523(a)(2)(A)**

23            (a) A discharge under section 727 . . . of this title  
24 does not discharge an individual debtor from any debt-

25            \* \* \*

26            (2) for money, property, services, or an  
             extension, renewal, or refinancing of credit,

1 to the extent obtained by—

2 (A) false pretenses, a false representation,  
3 or actual fraud, other than a statement  
4 respecting the debtor's or an insider's  
5 financial condition;

6 In order to prove fraud under § 523(a)(2)(A), a creditor  
7 must prove by a preponderance of the evidence the following five  
8 elements: (1) the debtor made a material misrepresentation, (2)  
9 with knowledge of its falsity, (3) with the intent to deceive,  
10 (4) on which the creditor justifiably relied, and (5) due to  
11 which the creditor sustained loss or damage. In re Kirsh, 973  
12 F.2d 1454, 1457 (9th Cir. 1992).

13 An officer or director of a corporation is not personally  
14 liable for a tort committed by one of its officers or subordinate  
15 agents merely by virtue of the office he holds. "An officer's  
16 personal liability is based upon his participation, knowledge  
17 amounting to acquiescence or the breach of some duty he owes to  
18 the owner of the property." Lewis v. Devils Lake Rock Crushing  
19 Co., 274 Or. 293, 297-298, 545 P.2d 1374, 1376-1377  
20 (1976) (internal citations omitted). However, "[i]t is not  
21 essential to the liability of a person who commits fraud that he  
22 should have obtained any benefit or advantage from the  
23 transaction." Creditors Protective Association v. Balcom et al.,  
24 248 Or. 38, 45, 432 P.2d 319, 322 (1967) (citing Sorenson et ux.  
25 v. Gardner et ux., 215 Or. 255, 334 P.2d 471 (1959)).

26 The complaint alleges that the Defendants, as officers and  
directors of SVI, directed SVI to violate the Letter of Agreement

1 and Security Agreement between SVI and the Plaintiff. Further,  
2 that Defendants directed SVI to violate various restraining  
3 orders and injunctions as well as the terms of a cash collateral  
4 order entered by the Bankruptcy Court. I cannot say it is beyond  
5 doubt that the Plaintiff, given the facts alleged in the  
6 complaint and the attached exhibits, cannot prove a set of facts  
7 entitling it to relief under 11 U.S.C. § 523(a)(2)(A). For  
8 example, it is possible that Plaintiff could prove that the  
9 Defendants, or one of them, made representations that SVI and/or  
10 the Defendants would do or not do certain things with respect to  
11 certain agreements or orders, knowing at the time that those  
12 representations were false and intending to deceive the  
13 Plaintiff. If damages and reliance can be proven, the Plaintiff  
14 would have made a claim under 11 U.S.C. § 523(a)(2)(A).<sup>1</sup>

15 **11 U.S.C. § 523(a)(6)**

16 (a) A discharge under section 727 . . . of this title does  
17 not discharge an individual debtor from any debt—

17 \* \* \*

18 (6) for willful and malicious injury by the  
19 debtor to another entity or to the property  
20 of another entity;

20 The U.S. Supreme Court recently issued an opinion holding  
21 that the term "willful" modifies the word injury, so that the  
22 injury must have been deliberately or intentionally caused, as

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24 <sup>1</sup> It should be noted that the Plaintiff must first prove liability on  
25 the part of the Defendants, including damages. A computation of damages  
26 resulting from a material misrepresentation or actual fraud of the Defendants  
would likely be different from the total amount of Plaintiff's claim, as it  
would be computed as the actual injury resulting from the actions complained  
of.

1 opposed to the act causing the injury having been deliberately  
2 done. The Court stated that § 523(a)(6) requires actions in the  
3 nature of intentional torts. Kawaauhau v. Geiger, 118 S.Ct. 974  
4 (1998).

5 The Plaintiff asserts that the actions of the Defendants  
6 complained of represent willful and malicious injury. It is  
7 possible from the actions alleged that Plaintiff could prove  
8 liability based on a cause of action such as willful conversion  
9 of Plaintiff's collateral. As stated previously with respect to  
10 liability for fraud under state law and extrapolated therefrom,  
11 it is not necessary that Defendants benefited personally from  
12 their actions in order to find liability on their part, merely  
13 that their actions constituted a tort and damages are found.

14 **11 U.S.C. § 523(a)(4)**

15 (a) A discharge under section 727 . . . of this title  
16 does not discharge an individual debtor from any debt—  
\* \* \*

(4) for fraud or defalcation while acting in  
a fiduciary capacity, embezzlement, or  
larceny;

19 The Plaintiff does not allege that the Defendants engaged in  
20 embezzlement or larceny; the complaint alleges fraud or  
21 defalcation while acting in a fiduciary capacity. The meaning of  
22 "fiduciary" in § 523(a)(4) is an issue of federal law. "The  
23 broad, general definition of "fiduciary" is inapplicable in the  
24 dischargeability context. . . . Instead, the fiduciary  
25 relationship must be one arising from an express or technical  
26 trust that was imposed before and without reference to the

wrongdoing that caused the debt." In re Lewis, 97 F.3d 1182, 1185 (9th Cir. 1996) (citing Ragsdale v. Haller, 780 F.2d 794, 795 (9th Cir. 1986)).

In other words, 'It is not enough that by the very act of wrongdoing out of which the contested debt arose, the bankrupt has become chargeable as a trustee ex maleficio. He must have been a trustee before the wrong and without reference thereto.'

Id. (citing Davis v. Aetna Acceptance Co., 293 U.S. 328, 331 (1934)). "Whether a fiduciary is a 'trustee in that strict and narrow sense' . . . is determined in part by reference to state law." Id. (citing Ragsdale at 796).

#### Fiduciary Relationship Under State Law

Plaintiff argues that the Defendants, as officers and directors of SVI, were trustees for the benefit of SVI's creditors at all times during which SVI was insolvent. Plaintiff cites to a case from Illinois for this proposition. See In re Reuscher, 169 B.R. 398 (S.D. Ill. 1994). Further, that SVI was insolvent at all times after the date it filed its first Chapter 12 bankruptcy.<sup>2</sup>

In Reuscher, the court stated that under Illinois law, officers and directors of a corporation ordinarily have a fiduciary relationship to only the corporation's shareholders and have no duty to creditors. However, citing to an Illinois case, once a corporation becomes insolvent, its assets are regarded as

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<sup>2</sup> In its Memorandum, Plaintiff states that the original Chapter 12 bankruptcy was filed on December 9, 1993. I take judicial notice of the fact that the case (692-64783-fra12) was actually filed on November 9, 1992.

1 a trust fund for the payment of its creditors, and the directors  
2 occupy a fiduciary relationship toward those creditors. The  
3 Reucher court then went on to hold that for purposes of §  
4 523(a)(4), a fiduciary duty arose between the corporation's  
5 officers and directors and the corporation's creditors from the  
6 time that the corporation became insolvent. Violation of that  
7 fiduciary duty could give rise to liability which would be  
8 nondischargeable under § 523(a)(4).

9 Plaintiff cites to an Oregon case for the proposition that  
10 officers and directors of an insolvent corporation owe a  
11 fiduciary duty to its creditors. See Bivens v. Hancock, 71  
12 Or.App. 273, 692 P.2d 153 (1984). In that case, the defendant  
13 was a controlling shareholder and director of the corporation.  
14 The defendant filed a quiet title action against the purchasers  
15 of corporate real property who had defaulted. The defendant  
16 quieted title in himself and then sold the property to another  
17 party, retaining the funds personally in payment of debts owed to  
18 him by the corporation. The court held that the defendant, in  
19 taking the actions that he did which resulted in quieting title  
20 in himself, had violated his fiduciary duty to the corporation  
21 and its creditors. A fraudulent transfer was held to have  
22 occurred. The court did not define, however, the nature of the  
23 fiduciary relationship. Moreover, it is not clear that a  
24 fiduciary relationship was a necessary prerequisite to finding a  
25 fraudulent transfer in that case. However, there is case law to  
26 the effect that Oregon has adopted what is termed the "trust fund

1 doctrine." See Gantenbein v. Bowles et al., 103 Or. 277, 203 P.  
2 614 (1922).

3 The point of time at which the directors lose power to  
4 prefer themselves as creditors, and at which the trust  
fund rule attaches is defined in 10 Cyc. 1056, thus:  
5 'This obligation to hold the assets of the corporation  
6 as a trust fund for equal distribution among its  
creditors attaches to the directors, not only when they  
7 have voted the corporation to be insolvent, but  
whenever the fact that it must discontinue business by  
8 reason of the insolvency comes to their knowledge.  
This knowledge of insolvency is not, and cannot from  
9 the very nature of things be, a positive knowledge. It  
is a reasonable belief founded upon probabilities  
10 having reference to the company's affairs. It is  
sufficient to put an end to the right of directors to  
prefer themselves as creditors for them to know that it  
is probably insolvent.'

11 Id. 103 Or. at 290 . Insolvency, as the inability to currently  
12 pay one's debts as they come due, however, must be differentiated  
13 from "going concern" in the cases cited. A going concern "is a  
14 term applied to a corporation which 'is still prosecuting its  
15 business with the prospect and expectation of continuing to do  
16 so, even though its assets are insufficient to pay its debts.'" "

17 Id. at 289 (internal citation omitted). In Oregon, the trust  
18 fund doctrine is not applicable to the assets of a corporation  
19 which is a going concern. See Garetson-Hilton Lumber Co. v.  
20 Hinson, 69 Or. 605, 609, 140 P. 633, 634 (1914). Therefore, the  
21 corporation's assets are not deemed to be in a trust fund for the  
22 benefit of creditors until such time as the corporation ceases to  
23 be a going concern.

24 Fiduciary Relationship Under Bankruptcy Law

25 In Chapter 11, the debtor-in-possession or a trustee is  
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1 authorized to operate the debtor's business unless the court  
2 orders otherwise. In Chapter 12, the debtor-in-possession is  
3 authorized to operate the debtor's business subject to such  
4 limitations as the court may prescribe. 3 COLLIER ON BANKRUPTCY  
5 ¶ 364.02 (15th ed. 1997). Prior to the appointment of a trustee  
6 in Chapter 11, the debtor-in-possession is a fiduciary of its own  
7 estate owing a duty of care and loyalty to the estate's  
8 creditors. See In re McConville, 110 F.3d 47, 50 (9th Cir.  
9 1997). A debtor-in-possession in Chapter 12 also has fiduciary  
10 duties to creditors with respect to the trust imposed by law upon  
11 the commencement of a bankruptcy case. See In re Erickson, 183  
12 B.R. 189 (Bankr. D. Minn. 1995). The property of the estate  
13 comprises either an express or technical trust for the benefit of  
14 creditors. The problem is that SVI was the debtor-in-possession,  
15 not the Defendants. However, a corporation cannot act except  
16 through its agents. As directors, chief executive officers, and  
17 controlling shareholders of SVI, the Defendants were in a  
18 position to control the actions of the corporation. Plaintiff  
19 may be able to prove at trial a fiduciary relationship between  
20 the Defendants and SVI's creditors. If such a fiduciary  
21 relationship can be proven, then any fraud or defalcation  
22 cognizable as a state law claim by the Defendants with regard to  
23 property of the estate may thus give rise to a nondischargeable  
24 debt under § 523(a)(4).<sup>3</sup>

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26 <sup>3</sup> Normally, a creditor's redress for violation of a court's order, the  
primary allegations of Plaintiff's complaint, is an order of contempt issued

1 To the extent that the complaint alleges improper actions of  
2 the Defendants with regard to property of the estate, Plaintiff  
3 may be able to prove a cause of action for fraud or defalcation  
4 under § 523(a)(4). Likewise, a cause of action under that  
5 section may be made under the "trust fund doctrine" if fraud or  
6 defalcation can be proven during a period when SVI was no longer  
7 a going concern.

8 CONCLUSION

9 The Defendant's motion to dismiss under Rule 60(b)(6) is  
10 denied. An order consistent with this Memorandum Opinion will be  
11 entered.

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14 FRANK R. ALLEY, III  
15 Bankruptcy Judge  
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23 by the court which had issued the original order. The contempt order can  
24 require that the debtor repay any unauthorized amounts. Under certain  
25 circumstances, contempt orders may be issued against the principals of a  
26 corporate debtor in Bankruptcy Court, See In re Snider Farms, Inc., 125 B.R.  
993 (Bankr. N.D.Ind. 1991) and in Oregon state courts, See O.R.S. 33.025(3).  
Mere violation of a court's order, however, does not automatically give rise  
to a state law claim unless the elements of such a claim can be proven.